

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA  
FRESNO DIVISION

In re ) Case No. 17-10245-B-13  
MICHAEL LLOYD LUSK and )  
CAROL ANN LUSK, )  
Debtors. )  
\_\_\_\_\_) Adv. Proceeding No. 17-1016-B  
SUSAN P. PETERSON, )  
Plaintiff, )  
v. )  
MICHAEL LLOYD LUSK, )  
Defendant. )  
\_\_\_\_\_)

MEMORANDUM DECISION

INTRODUCTION

11 U.S.C. § 523(a)(4) excepts from discharge an individual debtor’s debt for fraud or defalcation while acting in a fiduciary capacity. Debtor’s former spouse here asks the court to find nondischargeable a debt stemming from a previously adjudicated community property interest in defendant’s retirement benefits. The court holds that sufficient evidence has been presented establishing both the defendant’s defalcation and requisite intent. Consequently, the debt representing that previously awarded community property interest is nondischargeable.

FACTS

Early Events.

The provenance of this dispute begins in August 1994 with the dissolution of a nearly 12 year marriage between joint debtor Michael Lloyd Lusk ("Michael") and his former spouse Susan P. Peterson ("Susan").<sup>1</sup> Michael and Susan had one son, Matthew. During their marriage, Michael worked for Allstate Insurance Company. Then, Allstate offered two retirement plans: a traditional defined benefit pension ("Allstate Pension") and a 401(k) savings plan ("Allstate 401(k)"). Michael participated in both. The California Superior Court in Ventura County issued a dissolution judgment on August 5, 1994, which incorporated a lengthy Marital Settlement Agreement ("MSA"). The MSA identified the community property of the marriage, including "pension benefits in husband's (Michael's) name arising out of his employment with Allstate Insurance Company." Specifically, the MSA provided:

The parties agree that there is a community interest in the Husband's pension and retirement plan through his employment by Allstate Insurance Company. Wife's community interest in the plan will be calculated as follows: One Half of the product obtained by multiplying the amount of each retirement payment by the ratio of the months of Husband's employment with said employer during marriage and prior to separation over the total number of months of Husband's employment with said employer through the date of retirement. The parties further agree that the court

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<sup>1</sup> Throughout this Memorandum defendant, joint debtor Michael Lloyd Lusk will be referred to as "Michael" and the plaintiff in this case, his ex-spouse, Susan P. Peterson as "Susan." The first name references are for convenience only and no disrespect is intended.

1 that enters the decree of dissolution between them  
2 shall reserve jurisdiction to enforce the Wife's right  
3 to receive such payments from the Husband, or directly  
4 from the retirement plan.

5 The MSA identified the plan as "The Savings and Profit Sharing  
6 Fund of Sears Employees."

7 Over three years later, Susan and Matthew moved to South  
8 Carolina. This resulted in a stipulation and order to show cause  
9 signed by Susan and Michael and ordered by the superior court on  
10 August 8, 1997. The stipulation and order provided in part:

11 Petitioner (Susan) releases respondent (Michael) from  
12 any and all claims for spousal support for maintenance  
13 of any kind, and acknowledges and agrees that the  
14 waiver of spousal support set forth in this paragraph  
15 is made in consideration of their mutual promises,  
16 conditions, and agreements contained in this  
17 Agreement. Further, each party acknowledges and agrees  
18 there shall be no reservation of jurisdiction by the  
19 court to award spousal support beyond December 31,  
20 1997.

21 Less than two years later, Michael withdrew all the funds  
22 from the Allstate 401(k) without Susan's knowledge or consent  
23 and without paying any portion of the monies to Susan. Susan  
24 never received any monies from the Allstate 401(k).<sup>2</sup>

25 Interim Events.

26 In March 2005, Michael's 19-year employment with Allstate  
27 Insurance terminated. Michael's child support payments then  
28 either stopped or were less than required under the MSA. Matthew

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<sup>2</sup> Most of the facts in this opinion are undisputed and are part of the parties' joint pretrial order in this case.

1 graduated from high school in late spring 2005. Michael's  
2 scheduled final payment for child support was June 11, 2005.

3 Susan and Michael did not communicate much following the  
4 dissolution. Susan wrote letters to Michael discussing various  
5 topics, including Matthew's progress and Michael's performance  
6 under the MSA. Sometime in the summer of 2005, Susan and Michael  
7 agreed over the phone that Susan would accept a compromised  
8 amount for the child support arrearage. Susan testified that in  
9 that conversation she said that the only remaining issue between  
10 her and Michael was division of the Allstate Pension and  
11 Allstate 401(k) benefits. Susan testified that Michael said in  
12 that conversation that the Allstate Pension and Allstate 401(k)  
13 benefits were "not available to him right now."

14 In 2010, Matthew graduated from the University of Houston.  
15 Susan corresponded with Michael about the events. Included with  
16 the correspondence was a note that the "retirement plan is all  
17 we have to deal with." Michael did not respond.

18  
19 Withdrawals and Bankruptcy.

20 Michael requested that Allstate distribute the lump sum of  
21 his Allstate Pension. On September 6, 2013, he received  
22 \$578,686.19. Michael did not tell Susan about the withdrawal.  
23 Susan never received any monies from the Allstate Pension.

24 Six months later, in March 2014, Susan began inquiring  
25 about her interest in the Allstate Pension and the Allstate  
26 401(k).<sup>3</sup> Susan then retained an attorney, Darren Goodman, to  
27 assist her in discovering the status of the Allstate Pension and

28 <sup>3</sup> Joint Trial Exhibits (Ex. 4, 5 and 6). Plaintiff's Exhibits (Ex. 32-37).

1 the Allstate 401(k) and to prepare a Qualified Domestic  
2 Relations Order ("QDRO").

3 Mr. Goodman's efforts included issuing a subpoena to  
4 Allstate. Michael moved to quash the subpoena. A second attempt  
5 to subpoena Allstate was also met with Michael's Motion to  
6 Quash. Then, Michael realized that Susan was "not going away."<sup>4</sup>  
7 Michael signed a document authorizing Allstate to release  
8 information regarding the plans.

9 After she learned of the withdrawals, Susan hired counsel  
10 and filed a petition with the Ventura County Superior Court in  
11 August 2016, requesting orders for determination and  
12 distribution of the community property interests in the Allstate  
13 Pension and Allstate 401(k). Meanwhile, Michael had spent over  
14 \$200,000.00 of the Allstate Pension monies and all of the  
15 \$34,197.59 from the Allstate 401(k). Between 2014 and 2016,  
16 Michael purchased vehicles, motorcycles and a three-wheeled  
17 vehicle.

18 Michael had many financial demands beginning in March and  
19 April of 2005 when Michael lost a substantial salary. He also  
20 had medical expenses for his daughters after his marriage to his  
21 current wife, Carol Ann Lusk.

22 The Ventura County Superior Court held a trial on Susan's  
23 request for orders on October 26, 2016. The Superior Court made  
24 its findings and order after hearing on December 12, 2016. The  
25 Superior Court ruled that Susan's one-half share of the  
26 community property interest in the Allstate Pension is  
27 \$119,788.00. The Court ordered that "[Michael] Lusk shall pay  
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<sup>4</sup> Trial testimony (Day 1, 23:18-19).

1 (that amount) directly to (Susan) Peterson forthwith." The  
2 superior court also ruled that Michael's withdrawal of the  
3 \$34,197.59 from the Allstate 401(k) was a community property  
4 interest of his and Susan's marriage and ordered Michael to pay  
5 "forthwith to [Susan] Peterson \$17,089.00 as her one-half  
6 share." The court also awarded Susan attorney's fees and costs  
7 of \$10,000.00 and ordered Michael to pay that sum directly to  
8 Susan no later than December 31, 2016. Michael did not appeal  
9 the order.

10 Six weeks later, Michael and his current spouse, Carol Ann  
11 Lusk, filed this chapter 13 case. On May 16, 2017, the court  
12 confirmed a 60-month chapter 13 plan. Under the plan, the  
13 priority claims for unpaid taxes will be paid in full and  
14 unsecured creditors are to receive 5% on their claims. Susan  
15 filed this adversary proceeding, asking for an order determining  
16 that the \$146,877.00 awarded by the Ventura County Superior  
17 Court is nondischargeable under 11 U.S.C. § 523(a)(4), on  
18 February 23, 2017. She filed an amended complaint on March 10,  
19 2017. Susan filed a proof of claim on April 12, 2017 for the  
20 \$146,877.00 awarded by the Ventura County Superior Court.

21 The matter was tried on March 22 and 23, 2018. Following  
22 post-trial submissions, the record is now complete.  
23

#### 24 CONTENTIONS OF THE PARTIES

25 Susan contends that under California law, Michael held the  
26 Allstate Pension and Allstate 401(k) in a trust, that Michael  
27 owed her a fiduciary duty with respect to the disposition of the  
28 Allstate Pension and the Allstate 401(k), and that the fiduciary

1 duty was breached when the funds were removed from those plans  
2 and put under Michael's control without Susan's knowledge or  
3 consent. Also, she claims that Michael engaged in actionable  
4 defalcation and fraud in removing and expending the funds while  
5 acting as a fiduciary and thus the debt is nondischargeable  
6 under 11 U.S.C. § 523(a)(4). Plus, Susan contends that any  
7 remaining funds from either source are held in trust by Michael  
8 and Carol Ann Lusk for Susan's benefit. So, the remaining funds  
9 should be turned over to Susan.

10 Michael does not dispute that he took the funds without  
11 Susan's knowledge and that he owed a fiduciary duty to Susan  
12 regarding the community property interest in the Allstate  
13 Pension and the Allstate 401(k). He also admits that his  
14 fiduciary duty to Susan was breached when he withdrew those  
15 funds and did not pay Susan her community property share of the  
16 pension plan. But, Michael contends, he did not intentionally  
17 remove the funds, because he believed that Susan had no right to  
18 any of the funds. Also, Michael contends that when the Ventura  
19 County Superior Court awarded Susan \$146,977.00, that court did  
20 not identify a trust corpus and thus no express trust was  
21 created by the court order. Michael also contends that  
22 imposition of a constructive trust on any remaining funds is  
23 contrary to the chapter 13 plan and violates Carol Ann Lusk's  
24 rights. Carol Ann Lusk is not named as a defendant in this  
25 adversary proceeding.

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DISCUSSION

**1. Applicable standards in this litigation.**

One of the major policy objectives of the bankruptcy code is to provide the "honest but unfortunate" debtor with a fresh start. *Bujna v. McArthur (In re Bujna)*, 33 F.3d 1054, 1059 (9th Cir. 1994), citing *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991). Accordingly, the discharge provisions of the bankruptcy code are interpreted liberally in favor of debtors. *In re Bujna*, 33 F.3d at 1059. "Exceptions to discharge 'should be confined to those plainly expressed.'" *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) quoting *Gleason v. Thaw*, 236 U.S. 558, 562 (1915). Generally, a creditor seeking to except a debt from the debtor's discharge bears the burden of proof to establish by a preponderance of the evidence all of the elements of the statutory exception to discharge upon which the creditor relies. See *Grogan*, 498 U.S. at 287-88.

§ 523(a)(4) excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." To prevail under § 523(a)(4) for defalcation while acting in a fiduciary capacity, the plaintiff must show by a preponderance of the evidence that (1) an express trust existed; (2) the debt was caused by fraud or defalcation; and (3) the debtor acted as a fiduciary to the creditor at the time the debt was created. *Stephens v. Bigelow (In re Bigelow)*, 271 B.R. 178, 186 (9th Cir. B.A.P. 2001) (citing *Otto v. Niles (In re Niles)*, 106 F.3d 1456, 1459 (9th Cir. 1997), abrogated on other grounds, *Bullock v. Bank Champaign, N.A.*, 569 U.S. 267 (2013)).



1 In this case, there is no dispute that Michael acted as a  
2 fiduciary to Susan at the time the debt in this case was  
3 created. The debt was created when the Ventura County Superior  
4 Court entered the dissolution order in August 1994 and certainly  
5 when the court issued its orders liquidating the obligation in  
6 December 2016. Those orders have not been appealed and are  
7 final. Michael disputes the existence of a trust. Michael also  
8 disputes that he had the requisite intent when he withdrew and  
9 expended the funds from the Allstate 401(k) and the Allstate  
10 Pension. First, the trust.

11  
12 **2. An express trust existed over Susan's community property**  
13 **interest in the Allstate Pension and the Allstate 401(k) plans.**

14 For purposes of § 523(a)(4), a trust may be created by  
15 statute or by agreement. *In re Bigelow*, 271 B.R. at 186 *Lovelle*  
16 *v. Stanifer (In re Stanifer)*, 236 B.R. 709, 715 (9th Cir. B.A.P.  
17 1999). State law is relevant to determine whether there is an  
18 express or technical trust within the meaning of § 523(a)(4).  
19 *Stanifer*, 236 B.R. at 714.

20 State law here establishes the trust. In *In re Stanifer*,  
21 the Ninth Circuit Bankruptcy Appellate Panel examined California  
22 law and held that pursuant to California Family Code §§ 721 and  
23 1100(e) spouses are subject to the general rules governing  
24 fiduciary relationships that control actions of persons  
25 occupying confidential relationships with each other, including  
26 the duty of highest good faith and fair dealing, and the duty  
27 not to take unfair advantage of the other. *Stanifer*, 236 B.R. at  
28 717. California Family Code § 1100(e) specifically provides that

1 a spouse's fiduciary duty exists "until such time as the assets  
2 and liabilities have been divided by the parties or by a court."  
3 Here, the formula for dividing the Allstate Pension was included  
4 in the MSA adopted by the Ventura County Superior Court in 1994.  
5 But the property was undivided until the superior court issued  
6 its orders quantifying Susan's interests. The property was not  
7 divided because Michael expended all of the Allstate 401(k)  
8 benefits and most of the Allstate Pension benefits by the time  
9 court issued its order in December 2016.

10 The California Family Code imposes the fiduciary duty with  
11 regard to community property without regard to any act of wrong  
12 doing. See *Stanifer*, 239 B.R. at 709 and California Family Code  
13 § 2102. So under *Stanifer* and the controlling California  
14 statutes, a trust does exist by virtue of Michael's and Susan's  
15 marital relationship without regard to Michael's wrongdoing. The  
16 superior court's December 2016 order did not change that.  
17 Therefore, a requisite trust exists under California law and  
18 under the narrow scope of fiduciary relationships that qualify  
19 under § 523(a)(4). Next, the question of Michael's defalcation  
20 and culpable state of mind.

21  
22 **3. The plaintiff has proven Michael's defalcation and culpable**  
23 **state of mind.**

24 Defalcation is a misappropriation of trust funds or money  
25 held in any fiduciary capacity.<sup>5</sup> *Lewis v. Scott (In re Lewis)*, 97  
26 F.3d 1182, 1186 (9th Cir. 1996). Defalcation also includes the  
27 failure by a fiduciary to account for money or property that has

28 <sup>5</sup> "Misappropriation" is "the application of another's property or money  
dishonestly to one's own use." Black's Law Dictionary (10th ed. 2014).

1 been entrusted to him. *Pemstein v. Pemstein (In re Pemstein)*,  
2 492 B.R. 274, 282 (9th Cir. B.A.P. 2013). Once a creditor has  
3 shown that the debtor is a fiduciary to whom funds have been  
4 entrusted, the burden shifts to the fiduciary to account fully  
5 for all funds received. *In re Niles*, 106 F.3d at 1462.

6 Here, Michael was Susan's fiduciary with respect to the  
7 community property of the marriage until it was divided. It is  
8 undisputed that funds from both the Allstate Pension and the  
9 Allstate 401(k) were taken by Michael and deposited in his  
10 personal accounts without Susan's knowledge or consent. When  
11 asked by Susan's counsel at trial, Michael repeatedly did not  
12 recall how the monies deposited in those accounts was spent; he  
13 could not account for the money or property he held and under  
14 *Niles*, it was his burden to account fully for all funds  
15 received. Michael did not meet that burden, and thus did commit  
16 a defalcation under § 523(a)(4).

17 But, finding that a defalcation was committed is  
18 insufficient to make a debt nondischargeable. The creditor must  
19 also establish a "culpable state of mind ... involving knowledge  
20 of, or gross recklessness in respect to, the improper nature of  
21 the relevant fiduciary behavior." *Bullock*, 569 U.S. at 269. The  
22 conduct must involve bad faith, moral turpitude, other immoral  
23 conduct, or an intentional wrong (meaning conduct the fiduciary  
24 knows is improper or if the fiduciary "consciously disregards"  
25 or is willfully blind to a "substantial and unjustifiable risk"  
26 that his conduct will violate the fiduciary duty). *Id.* at 273-  
27 74. Put another way, a bankruptcy court needs to find that the  
28 debt resulted from (i) acts of bad faith, moral turpitude, or

1 other immoral conduct; (ii) intentional improper conduct or  
2 criminally reckless conduct; or (iii) conscious disregard or  
3 willful blindness to a substantial and unjustifiable risk. *Heers*  
4 *v. Parsons (In re Heers)*, 529 B.R. 734, 742-43 (9th Cir. B.A.P.  
5 2015).

6 The court observed the demeanor of Michael and Susan during  
7 the trial. Both gave responsive answers to the questions  
8 presented. Both appeared to be intelligent and thoughtful. Both  
9 have professional or semi-professional backgrounds: Michael as  
10 an insurance agent and Susan in the medical field. Michael's  
11 demeanor on the stand supported that he is someone who has  
12 succeeded in a contractually based field (insurance). His  
13 general demeanor as a witness establishes for the court that he  
14 was aware of the risks involved in his acquisition and  
15 expenditure of the Allstate Pension and Allstate 401(k) funds.  
16 While some of the facts about Michael's "state of mind" relating  
17 to the defalcation are disputed based on the evidence and  
18 testimony, there are four reasons supporting a finding that  
19 Michael had a culpable state of mind.

20 First, Michael was represented by counsel when the original  
21 MSA became part of the dissolution judgment. The MSA confirms  
22 the community interest in Michael's pension and retirement plan  
23 and provided a calculation for the extent of Susan's interest.  
24 Both Michael and Susan signed the MSA and it became part of the  
25 Ventura County Superior Court's order in 1994. The document  
26 directly contradicts Michael's testimony that it was both his  
27 and Susan's intent that they each would "keep [their] respective  
28 retirement plans."

1 Susan testified she understood that under the MSA she  
2 needed to wait until Michael reached retirement age before she  
3 could enforce her community property rights. That was probably  
4 incorrect. That said, it does not change Michael's legal status  
5 as a fiduciary. Further, there was no evidence presented that  
6 Michael relied upon Susan's misunderstanding or made any effort,  
7 as a fiduciary, to correct her error.

8 Second, Michael's contention that the 1997 order changed  
9 his obligation to Susan concerning the Allstate retirement  
10 benefits is inconsistent with the order's provisions or the  
11 party's actions. The 1997 order did release Michael from "any  
12 and all claims for spousal support or maintenance of any kind."  
13 The 1997 order also provides that each party acknowledge and  
14 agreed there would be no reservation of jurisdiction by the  
15 court to award spousal support beyond December 31, 1997. The  
16 superior court orders are final and conclusively determined the  
17 rights of the parties as of the dates they were entered. Michael  
18 contends his subjective understanding is contrary to the terms  
19 of the orders. Unfortunately, that understanding is irrelevant.

20 Marital settlement agreements incorporated into a  
21 dissolution judgment are construed under the statutory rules  
22 governing the interpretation of contracts generally. *In re*  
23 *Diener*, 483 B.R. 196, 206 (9th Cir. B.A.P. 2012) (citations  
24 omitted). Under California contract law, the court must  
25 interpret the contract to give effect to the parties' mutual  
26 intent at the time they made the contract. California Civil Code  
27 § 1636; *TRB Investments, Inc. v. Fireman's Fund Insurance*  
28 *Company*, 40 Cal. 4th 19 (2006) ["the 'clear and explicit'

1 meaning of provisions [in a contract] interpreted in their  
2 'ordinary and popular sense,' in the absence of evidence to the  
3 contrary, controls judicial interpretation"]; California Civil  
4 Code §§ 1638, 1644; *AIU Insurance Company v. Superior Court of*  
5 *Santa Clara County*, 51 Cal. 3rd 807 (1990). A court may look to  
6 general dictionary definitions to aid its analysis of a term's  
7 meaning. *Scott v. Continental Insurance Company*, 44 Cal. App.  
8 4th 24 (1996).<sup>6</sup>

9 The 1997 order only modifies maintenance and support and  
10 does not deal with property division. As used in that order,  
11 "maintenance" means "financial support given by one person to  
12 another, usually paid as a result of legal separation or  
13 divorce; especially, alimony."<sup>7</sup> "Maintenance" has also been  
14 defined as "the act of providing means of support for someone."<sup>8</sup>  
15 In its conventional and ordinary sense, "maintenance" means the  
16 same thing as "support." The concepts of "support" and property  
17 division are distinct in the original MSA. That was not changed  
18 by the 1997 order. Michael's claim that the 1997 order waived  
19 Susan's property rights is inconsistent with the plain and  
20 ordinary meaning of the terms of the order.

21 Third, Susan's unchallenged testimony about her  
22 conversations with Michael on the subject establish a known  
23 risk. The division of the retirement benefits was a subject of  
24 the original MSA. Shortly after Matthew graduated high school in  
25

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26 <sup>6</sup> Black's Law Dictionary qualifies as a general dictionary for purposes  
27 of contract interpretation. See, *Flinkote Company v. General Accident*  
28 *Assurance Company of Canada*, 410 F.Supp.2d 875, 887-88 (N.D. Cal.  
2006)(citing *Cooper Companies v. Transcon Insurance Company*, 31 Cal. App. 4th  
1094 (1995)).

<sup>7</sup> Black's Law Dictionary (10th ed., 2014).

<sup>8</sup> Webster's Third New International Dictionary (2002).

1 2005, Michael and Susan discussed the retirement and savings  
2 plan over the phone. Michael responded "that (the pension  
3 benefits) was not available to him right now." Michael did not  
4 recall the telephone call. Michael and Susan testified that  
5 there were infrequent communications between them. Given the  
6 infrequency of the communications, and the size of the  
7 retirement benefits eventually paid to Michael, it is not  
8 credible that Michael was unaware that Susan was claiming an  
9 interest in the retirement benefits. In fact, Michael testified  
10 that he subjectively knew Susan was not going to "go away."

11 When Michael was eligible for the pension benefit (the  
12 401(k) benefit had then been expended) in 2013, he received a  
13 cash payment from Allstate. He did not tell Susan that he  
14 received the funds. Susan hired counsel to investigate the  
15 matter and prepare a QDRO. Michael moved to quash two subpoenas  
16 Susan's counsel had issued seeking information from Allstate.  
17 So, not only did Michael keep the distribution a secret from  
18 Susan but also affirmatively tried to stop further inquiry. Even  
19 after Michael knew Susan was not going to "go away" he expended  
20 substantial funds from his and his current wife's accounts in  
21 2013-2015.

22 Michael testified that he had needs for funds, including  
23 operating his business, caring for his daughters, and purchasing  
24 vehicles. All of those needs are understandable. That said, the  
25 superior court established that Michael had other obligations as  
26 well, stemming from his marriage to Susan. Even if one assumes  
27 Michael reasonably believed he had no further obligation to  
28 Susan following the 1997 order, as recently as 2005, Michael

1 knew the risk of proceeding under that assumption when Susan  
2 continued to communicate her expectation of receiving a portion  
3 of the Allstate Retirement Benefits. Michael knew of the risk  
4 and proceeded to act facing that risk.

5 Fourth, the 2016 Ventura County Superior Court order  
6 liquidating Michael's obligation establishes the requisite  
7 intent. When Susan learned that the retirement proceeds were  
8 distributed to Michael, she petitioned the superior court for  
9 orders determining her community property interests in the  
10 retirement plans. Michael and Susan were represented by counsel  
11 at the hearing on October 26, 2016. The court's order after  
12 hearing entered December 12, 2016 awarded Susan \$119,788.00  
13 representing Susan's one-half share of the community property  
14 interests in the Allstate Pension and \$17,089.00 representing  
15 one-half of the Allstate 401(k) funds that Michael withdrew in  
16 1999. The court also granted Susan's request for attorney's fees  
17 and awarded \$10,000. The issues which Michael raises here in  
18 defense of Susan's claim may have been and certainly could have  
19 been raised at the October 2016 hearing. The superior court  
20 relied upon the provisions of the MSA. It is also undisputed in  
21 this case that Michael had not paid Susan any of the funds from  
22 the Allstate Pension or Allstate 401(k). Michael's arguments are  
23 not persuasive. To further support that conclusion, there is  
24 uncontroverted evidence that during 2016, even after Susan had  
25 petitioned the superior court, withdrawals were made from  
26 accounts while the issues were pending before the Superior  
27 Court.



1       The foregoing reasons all support the court's finding that  
2 in addition to committing a defalcation, Michael had the  
3 requisite culpable state of mind making the Ventura County  
4 Superior Court's award on December 12, 2016 in the amount of  
5 \$146,877.00 nondischargeable under 11 U.S.C. § 523(a)(4).

6       Next, the court will briefly discuss remedies.

7  
8 **4. The court does not find that the imposition of a**  
9 **constructive trust is appropriate.**

10       Throughout this litigation, Susan has changed the focus of  
11 the remedy she seeks. The first amended complaint simply prays  
12 for an order determining that the sum of \$146,877.00 is  
13 nondischargeable. The joint pretrial order states that Susan is  
14 seeking an order determining that Michael holds \$146,877.00 in  
15 trust for Susan and compelling him to turn the monies over to  
16 her. Yet, Susan's post-trial submission does not stress the  
17 issue and offhandedly states that since Michael held the funds  
18 in express trust for Susan, turnover of the remaining funds is  
19 appropriate. The court is not convinced.

20       The bankruptcy court must act very cautiously in exercising  
21 the remedy of constructive trust, "a remedy of relatively  
22 undefined equitable power" to override the bankruptcy priority  
23 scheme. *In re North American Coin & Currency*, 767 F.2d 1573,  
24 1575 (9th Cir. 1985) cert. den. sub nom *Torres v. Eastlick*, 475  
25 U.S. 1083 (1986). This proscription is to be observed  
26 notwithstanding whatever presumption California law may have  
27 since it cannot conflict with Federal bankruptcy law. *Toys "R"*  
28 *Us, Inc. v. Estrow Inc. (In re Estrow Inc.)*, 645 F.2d 794, 797-

1 98 (9th Cir. 1988). There is, accordingly, a "strict tracing"  
2 requirement before a constructive trust can be imposed. Under  
3 the standard applicable to bankruptcy cases involving comingled  
4 funds, the plaintiff has the burden of tracing the trust  
5 property "specifically and directly" back to the illegal  
6 transfers giving rise to the [constructive] trust. *Taylor*  
7 *Associates v. Diamant (In re Advent Management Corp.)*, 104 F.3d  
8 293, 296 (9th Cir. 1997). "Such a tracing requirement is  
9 necessary to further the bankruptcy policy of equitable  
10 distribution among similarly situated creditors." *In re Bullion*  
11 *Reserve of North America*, 836 F.2d 1214, 1218 (9th Cir. 1988).

12 Here, the plaintiff has established through Michael's  
13 testimony that funds from the Allstate Pension were deposited in  
14 personal accounts and that withdrawals were made from those  
15 accounts. However, plaintiff has not strictly traced those funds  
16 to specific assets. Rather, the plaintiff seems to be asking the  
17 court to presume that each withdrawal from Michael and his  
18 current spouse's accounts necessarily involved simply Allstate  
19 Pension funds. The evidence does not support that assumption.  
20 Also, since the court must be circumspect in imposing a remedy  
21 that would be contrary to priority scheme under the bankruptcy  
22 code, far more evidence of direct tracing would be needed.

23 On balance, the court is not convinced Susan has met her  
24 burden on strict tracing and the court declines to impose a  
25 constructive trust. The court is also mindful of the fact that  
26 Michael's current spouse is not a defendant in these proceedings  
27 and that the imposition of a constructive trust would have the  
28

1 effect of circumventing a chapter 13 plan which has already been  
2 confirmed by the court.<sup>9</sup>

3  
4 **5. Attorney's fees will not be awarded for this proceeding at**  
5 **this time.**

6 The debt this court adjudges as nondischargeable includes  
7 \$10,000.00 of attorney's fees awarded by the Ventura County  
8 Superior Court.

9 In *Cohen v. De La Cruz*, 523 U.S. 213 (1998), the Supreme  
10 Court rejected Michael's contention here that Susan's attorney's  
11 fees awarded by the Superior Court are dischargeable since they  
12 were not part of the alleged defalcation. Analyzing the extent  
13 of a non-dischargeable fraud claim under § 523(a)(2), the Court  
14 specifically rejected the "restitutionary ceiling" on recovery  
15 urged by Michael here. *Id.* at 219-21. The court in *Cohen*  
16 affirmed the lower court's holding which included attorney's  
17 fees (and treble damages) previously awarded plaintiff by the  
18 state court even though those amounts "exceed the value obtained  
19 by the debtor" from the fraud. The court held:

20 Once it is established that specific money or property  
21 has been obtained by fraud, however, "any debt arising  
22 therefrom is excepted from discharge." *Id.* at 218 ...  
23 any liability traceable therefrom plus attorney's fees  
24 and costs falls within that exception [from  
25 discharge]. *Id.* at 219.

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26 <sup>9</sup> Since the court has declined to impose a constructive trust, the court  
27 will not consider the "unclean hands" defense raised by Michael in this  
28 proceeding. The defense is based on the disputed fact that Susan had  
undisclosed retirement benefits when the marriage dissolved. Even if  
relevant, the court is not persuaded that Michael met his burden of proof on  
the defense.

1 The Court examined the definition of "debt" and "claim" under  
2 the Bankruptcy Code, §§ 101(12) and (7) respectively, and  
3 further defined "claim" as an enforceable right to payment.  
4 *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S.  
5 552, 559 (1980). Finding the treble damages and attorney's fees  
6 enforceable rights of payment, the Court included that relief in  
7 the exception to discharge. *Id.* at 223. The attorney's fee for  
8 "establishing the fraud" were included. *Id.*

9 This same analysis has been applied to claims that a debt  
10 is nondischargeable under § 523(a)(4). See, *In re Palombo*, 456  
11 B.R. 48, 64 (Bankr. C.D. Cal. 2011) [Misaccounting for ERISA  
12 plan funds by a plan trustee]; *Indo-Med Commodities Inc. v.*  
13 *Wisell (In re Wisell)*, 494 B.R. 23, 43 (Bankr. E.D. N.Y. 2011);  
14 *Barrett v. Barrett (In re Barrett)*, 410 B.R. 113 (Bankr. S.D.  
15 Fla. 2009). Here, the Ventura County Superior Court was clear in  
16 awarding \$10,000.00 for Susan's attorney's fees. The court  
17 awarded the fees as "attorney's fees and costs that were  
18 incurred to enforce the provisions of the judgment in the sum  
19 requested of \$10,000.00, as reasonable fees and costs incurred."  
20 The Superior Court has determined the \$10,000.00 is stemming  
21 from the defalcation.

22 To be sure, the fees that may be an element of Susan's  
23 damages stemming from the defalcation differ from the fees she  
24 incurred in pursuing this litigation. Susan claims that the  
25 provisions of the MSA support an award of attorney's fees if  
26 Susan is the prevailing party in this case. Susan relies on  
27 California Code of Civil Procedure § 1021. In support of her  
28

1 interpretation, Susan cites *3250 Wilshire Boulevard Building v.*  
2 *W.R. Grace & Co.*, 990 F.2d 487, 489 (9th Cir. 1993).

3 *Wilshire* does not support Susan's interpretation. In  
4 *Wilshire* the Ninth Circuit looked to the provisions of the  
5 contract itself and found that the broad provisions in the  
6 contract between the parties encompassed the claims in that  
7 case. The importance of the contract provision itself in an  
8 analysis under California Code of Civil Procedure § 1021 cannot  
9 be ignored. See, *Mitsui O.S.K. Lines Limited v. Seamaster*  
10 *Logistics, Inc.*, 618 Fed. App. 304, 307 (9th Cir. 2015)  
11 [contract provision did not support extension of California Code  
12 of Civil Procedure §1021]; *Taburaza v. Zarate (In re Zarate)*,  
13 567 B.R. 176 (Bankr. N.D. Cal. 2017) [same]. The court is not  
14 ruling that attorney's fees are not recoverable for pursuit of  
15 this litigation. However, it is premature for the court to rule  
16 on the issue without significant analysis and briefing by the  
17 parties on whether the provisions of the MSA support an  
18 attorney's fees award. Fortunately, Federal Rule of Civil  
19 Procedure 54 (incorporated in part by Federal Rule of Bankruptcy  
20 Procedure 7054) provides a procedure for the attorney's fees  
21 issue to be litigated.

22 The court declines without prejudice to award attorney's  
23 fees to Susan at this time.


#### 24 25 CONCLUSION

26 For the foregoing reasons, judgment shall be entered in  
27 favor of Susan P. Peterson and against Michael Lloyd Lusk that  
28 the sum of \$146,877.00 awarded by the Ventura County Superior

1 Court is nondischargeable under 11 U.S.C. § 523(a)(4).  
2 Attorney's fees are not awarded at this time. Counsel for the  
3 plaintiff shall prepare a judgment in conformance with this  
4 ruling within 14 days from the date of this Memorandum Decision.  
5 Any requests for attorney's fees shall be governed by Federal  
6 Rule of Bankruptcy Procedure 7054.

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11 Dated: Jul 05, 2018

By the Court

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14 René Lastreto II, Judge  
15 United States Bankruptcy Court  
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1                                   **Instructions to Clerk of Court**  
2                                   **Service List - Not Part of Order/Judgment**

3                   The Clerk of Court is instructed to send the Order/Judgment  
4 or other court generated document transmitted herewith to the  
5 parties below. The Clerk of Court will send the Order via the  
6 BNC or, if checked   X  , via the U.S. mail.

7                   Debtor(s), Attorney for the Debtor(s), Bankruptcy Trustee  
8 (if appointed in the case), and   X   Other Persons Specified  
9 Below:

10                   Hagop T. Bedoyan  
11 5260 N. Palm Avenue, Suite 205  
12 Fresno CA 93704

13                   Peter B. Bunting  
14 2304 W Shaw Ave, Suite 103  
15 Fresno CA 93711

16                   Michael H. Meyer  
17 PO Box 28950  
18 Fresno CA 93729-8950

19                   Office of the U.S. Trustee  
20 United States Courthouse  
21 2500 Tulare Street, Room 1401  
22 Fresno CA 93721  
23  
24  
25  
26  
27  
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